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Before the  
**FEDERAL COMMUNICATIONS COMMISSION** JAN 27 1993  
Washington, D.C. 20554

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

In the Matter of

Implementation of Sections  
of the Cable Television  
Consumer Protection and  
Competition Act of 1992

Rate Regulation

MM Docket No. 92-266

COMMENTS OF CABLEVISION INDUSTRIES CORPORATION

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## **SUMMARY**

The Commission's rate regulation regime must reflect the goals of the Cable Television Consumer Protection and Competition Act of 1992 (the "1992 Act"). The Commission must implement regulations enabling the cable television industry to retain flexibility to respond to competition and the increasing demands of the electronic age. This means that the Commission must follow Congress' prescription for regulating basic and cable programming service rates while also ensuring a fair return on the industry's enormous investments in plant and programming services.

If these considerations are taken into account, the Commission should adopt a benchmarking, rather than a cost-of-service regime, for both the regulation of basic and programming service rates. Benchmarking is superior to cost-of-service regulation, which creates inappropriate incentives and is too cumbersome to implement. Benchmarking minimizes the burdens on all parties while assuring that rates at or below the benchmark are reasonable.

A defined set of criteria should be applied to determine the basic service rate benchmark of each cable system. Initial benchmarks should be set based on a system's channel capacity, the number of subscribers served and other factors which are relevant to determining reasonable rates. Basic service benchmarks should be adjusted to account for inflation, changes in the cost of capital, retransmission consent costs, the costs of franchise requirements and other costs that are outside the cable operator's control. Cable operators also should be permitted to show that above-benchmark rates are reasonable based on any

relevant factors, including unusual geography, high capital costs and costly franchising requirements.

The Commission can also use benchmarking to oversee cable programming service rates, although here it must be tailored to the requirements of a less-stringent regulatory regime. Cable programming service benchmarks should be based on the overall price for cable service, and operators should be given credit for below-cost installation and equipment offerings. Programming service benchmarks should provide for: (1) adjustments for inflation, the cost of capital and other costs that affect all cable service; (2) pass-throughs for costs that affect basic service; and (3) costs that affect cable programming service directly, including programming, rebuilds, upgrades and system expansion. Cable operators must also be afforded the discretion to justify above-benchmark rates, based on all the factors that apply to basic service. Additionally, other factors, including unusually expensive rebuilds and new programming costs that apply specifically to cable programming service, should be considered.

Regulation of equipment, installation and charges for changes in services should be easy to administer and protect both subscribers and cable operators. The Commission should adopt equipment pricing standards based on appropriate national average equipment costs which account for a reasonable return. Regulations for installation should define only a reasonable maximum charge to encourage low-cost installation that will make cable service more widely available to the public. In order to avoid unwarranted restrictions on reasonable marketing practices for other services, charges for changes in service should be regulated only for basic cable service.

The Commission should set maximum prices for leased access services that are based on cable programming service benchmarks, but provide for exceptions for programming such as pay channels that may impose additional costs on the operator. The Commission does not have the authority to set a lower maximum rate for not-for-profit programmers. The regulation of the terms and conditions of leased access should otherwise be limited in order to provide the parties with maximum flexibility. Alternative dispute resolution is an appropriate way to approach to addressing disputes over leased access services.

The certification procedures that the Commission establishes must comport with the requirements of the 1992 Act. Franchising authorities should implement their regulations before certification becomes effective. The certification procedure should be stayed when a certification is opposed, and an expedited pleading schedule should be implemented to resolve contested certifications. Unless a certification has been denied or revoked, the Commission does not have the authority to regulate basic cable service rates.

The 1992 Act dictates that the Commission should make the final determination whether a cable system is subject to effective competition. This determination will have to be established on a case-by-case basis unless the Commission establishes annual reporting requirements for all multi-channel video programmers. When a cable operator and a franchising authority determine that a cable system has become subject to effective competition, decertification of the franchising authority should be automatic.

Rate increases that fall within Commission benchmarks should be effective upon required notification and without a franchising authority's prior approval.

Franchising authorities should have sixty (60) days to consider rate increase requests, and a decision to deny a proposed rate should be made in writing and supported by substantial evidence. Franchising authorities should be permitted access to rate-related information only when rates fall above a benchmark, and then only when safeguards for confidentiality are in place. When the Commission exercises basic cable service rate regulation, it should generally follow the procedures that it adopts for the regulation of basic cable service rates. Appeals of basic service rate decisions should be made directly to the Commission. Otherwise, the likelihood is that there will be non-uniformity in decisions from city to city and from state to state. Franchising authorities do not have the power to order refunds, but franchise agreements provide other enforcement powers.

Complaint procedures for processing complaints of unreasonable rates for cable programming services should be adopted that minimize administrative burdens on the Commission, subscribers, and operators. Complaints should be submitted on a standard form and within thirty (30) days of a rate increase. A response should be required by an operator only if the Commission needs additional information to determine whether a rate falls within a benchmark. A cable operator should be provided with the opportunity to demonstrate that a cable programming service rate is not unreasonable, and an unresolved issue of fact must be resolved by a hearing. Prior to a hearing designation order, the Commission should rely on relaxed ex parte rules. Cost information provided by an operator during the complaint process should be afforded confidential treatment. The burden of showing that cable programming rates are unreasonable

should be on the complainant. Refunds granted by the Commission should be made on a pro rata basis to current subscribers.

The legislative history of the 1992 Act makes it clear that rates must be uniform throughout a franchise area rather than system-wide. Section 623(d), which requires uniform rates, does not pertain to multiple dwelling units and similar accounts.

Cable operators have the flexibility to place more than the minimum number of required channels on the basic tier. Franchise agreements that require specific channels or a minimum number of channels in basic service should be preempted. The 1992 Act permits cable operators to require the purchase of a non-basic tier as a prerequisite to other tiered services. The 1992 Act also permits cable operators to offer pay channels and pay-per-view services to customers who do not purchase basic service, and a subscription to a video service should not be a prerequisite to a subscription to a non-video service. Pay-per-view and per channel services that are bundled are not subject to rate regulation. The Commission need not adopt regulations to implement the negative option billing provisions of the 1992 Act. Violations of this provision can be adequately enforced through the Commission's complaint process.

Congress directed the Commission to promulgate rate regulations by April 3, 1993. However, this does not require that all of the regulations must take effect by this date. The Commission should implement the 1992 Act's rate regulation provisions so that franchising authorities, the public, and the cable industry all have adequate time to adjust to the regulations that will be adopted pursuant to this Rule Making.

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Consumer Protection and	)	
Competition Act of 1992	)	
	)	
Rate Regulation	)	

**COMMENTS OF CABLEVISION INDUSTRIES CORPORATION**

Cablevision Industries Corporation ("CVI"), by its attorneys, hereby submits comments in the above-captioned proceeding.<sup>1/</sup> CVI began in the cable television industry in 1956. Today it is one of the largest privately-held cable companies and the ninth largest cable operator. CVI associated systems are located throughout the United States in Metropolitan areas as well as rural communities, providing service to nearly 1.2 million subscribers. As a company that has made hundreds of millions of dollars in capital expenditures since 1986 to bring new and improved services to its subscribers, CVI brings an important perspective to this proceeding.

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<sup>1/</sup> *Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992, Rate Regulation, Notice of Proposed Rulemaking*, MM Dkt. No. 92-266, (released Dec. 24, 1992) (the "Notice").

**I. THE COMMISSION HAS THE DISCRETION TO CHOOSE THE FORM OF RATE REGULATION THAT WILL BEST MEET ALL OF THE GOALS OF THE 1992 ACT.**

The Cable Television Consumer Protection and Competition Act of 1992, P.L. 102-385, 106 Stat. 1460 (1992) (the "1992 Act"), was not merely a rate regulation law. It was intended to bring multiple benefits to cable consumers, ranging from low cost basic service to equipment compatibility. As it formulates rate regulations under the 1992 Act, the Commission should consider all of the Act's goals, and not focus merely on isolated provisions.

Considering the Act as a whole is particularly important for regulation of cable programming service. Trying to reduce all cable rates to their absolute minimum would cause irreparable economic harm to the cable industry. Moreover, this approach would make it impossible to achieve the other goals of the 1992 Act and would be directly contrary to the Act's own injunction, discussed in the *Notice*, that the Commission consider a multiplicity of factors, *Notice* at ¶ 54. In this context, the Commission also should take the financial needs of the cable industry into account as it designs its regulatory scheme.

**A. A Regulatory Regime That Assures Low Rates For Basic Service Must Also Preserve Cable Operators' Flexibility To Improve Their Service and Respond To Competition.**

At paragraph 32 of the *Notice* the Commission asks for comments on whether it should try to assure that cable operators make limited service, low

cost basic tiers available; one of the primary objectives of the 1992 Act.<sup>2/</sup> In fashioning its regulatory directives, however, the Commission also must provide cable operators with sufficient flexibility to continue to improve their services and to meet other obligations imposed by the new law which will affect the cost of delivering services to consumers. Only if cable operators have the flexibility to improve their service and compete effectively will they keep up with subscriber demands and provide the technological innovations already beginning to enter the marketplace.

The Cable Communication Policy Act of 1984; Pub. L. 98-549, 98 Stat. 2779, (1984) (the "1984 Act") gave cable operators new freedom to improve their services. This in turn led to significant improvements in the availability and diversity of cable service, along with many important cable programming innovations. As the Commission explained in its 1990 Cable Report: "Deregulation under the [1984] Cable Act has fostered the intended results: increases in investment, with corresponding expansion of cable reach, number of subscribers, channel capacity and new programming." *Competition, Rate Deregulation and the Commission's Policies Relating to the Provision of Television Service*, 5 FCC Rcd. 4962, 4971 (1990) (the "FCC Cable Report"). The public responded by purchasing more cable service and watching more cable programming. In fact, cable subscribership increased by 18 million households

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<sup>2/</sup> As discussed in Part VII(G), *infra*, the Commission should preempt any franchise that requires broader basic service. Low-cost basic is only one of several important goals of the 1992 Act, including the anti-buy-through provisions, improved customer service, and setting new technical standards.

from 1984 to 1991, to a total of 55 million households. National Cable Television Association, *Cable Television Developments*, at 2-A (Oct. 1992) ("*Cable Developments*"). At the same time, viewership of cable-based programming in cable households jumped from 19% to 35% over roughly the same time period. *Id.* at 5-A.

This growth came because cable operators made enormous investments in cable plant and cable programming and continue to do so today. Investment in new and expanded plant/channel capacity increased by 55% from 1984 to 1989. *FCC Cable Report*, 5 FCC Rcd at 4966. As capacity has increased the number of new cable programming networks kept pace. The number of cable networks increased from 41 in 1983 to 76 in 1991. *Cable Developments* at 7-A. Investments in improved facilities made more channels available to the average subscriber and pioneered technological improvements. Fiber optics, for instance, greatly increase the reliability of cable service. National Cable Television Association, *The Future of Television*, at 8-9 (1990).

The quality of cable programming has steadily improved as well. For instance, a 1990 poll indicated that the American public believes that cable television programming offers more variety and is more interesting than conventional broadcast television.<sup>3/</sup> Forty-nine Emmy nominations were received

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<sup>3/</sup> National Cable Television Association, *Reregulation of Cable Television Rates Would Choke Off Investment in New Programming and Improved Cable Technology* 3 (Dec. 1991). According to the poll, approximately 47% of those polled felt that cable television provided a wide variety of viewing options. Only 28% of respondents expressed the same view about broadcast television. *Id.*

by the cable industry in 1992 recognizing the quality of cable programming. *See Brand, Falsey Win Another Emmy Bid*, Los Angeles Times, Jul. 23, 1992 at F10. In addition, the U.S. Conference of Mayors passed a unanimous resolution praising the cable television industry's commitment to public service programming which brings "important events to the American people and City residents in new and better ways." *Id.* These facts confirm the Commission's own conclusion in 1990 that "the American public has clearly welcomed the wider viewing options that the cable industry has provided." *FCC Cable Report*, 5 FCC Rcd. at 4968.

These improvements in cable services did not occur in a vacuum; as the Commission found in 1990, they resulted from permitting cable operators the financial and operating flexibility to respond to their marketplace. Had an inflexible regime of rules been imposed, the cable industry would never have advanced to its present state.

Cable operators are also faced with increasing competition. Satellite services, including SMATV, already are important competitors in some areas, while MMDS operators provide a wireless alternative to cable. Direct broadcast satellite service, video dialtone services and the recently-proposed LMDS service will compete with cable very soon.<sup>4/</sup> This proliferation of technology demands that cable operators be able to compete on price and on the quality of the service they provide. If they are not allowed to compete effectively

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<sup>4/</sup> Direct broadcast satellite service is likely to begin in the United States within the next several months. *See Echosphere Will Launch DBS Venture that Could Compete with Its Own Market*, Comm. Daily, Jan. 20, 1993 at 4, describing DirecTV's plans to launch satellite in early 1993).

as a consequence of regulation, the Commission will have jeopardized all of the progress in programming and service that has occurred over the past six years. This would contravene the goals of the 1992 Act and ill-serve the public interest.

The two-tiered regulatory scheme in the 1992 Act enables the Commission to give cable operators the flexibility they need. Only basic service is directly regulated, while non-basic service is subject to a complaint process wherein the Commission may make determinations regarding unreasonable rates. As described below, the Commission can adapt its benchmarking proposal to fit both regulatory models. Under this approach, basic service benchmarks will control rates, while benchmarks for cable programming service will identify rate excesses through an adversary process.

A flexible approach will also help the Commission accommodate the 1992 Act's emphasis on simple rules. Rate regulation based on simple requirements will give cable operators the opportunity to adjust their programming, construction, and other operations in order to meet market needs. At the same time, simplicity will ease compliance burdens on cable operators, and give franchising authorities and the Commission fewer administrative obligations. Simple regulations will also make it easier for consumers to understand their rights and avoid the unnecessary litigation inevitably associated with complex regulations.

**B. The Commission Must Consider The Financial Characteristics Of The Cable Industry When It Promulgates Rate Regulation Policies.**

Any regulatory scheme must consider the often delicate financial character of the industry upon which it will be imposed. The cable industry has unique financial features which must be considered to avoid interfering with the legitimate "investment-backed expectations" of cable owners and avoid instability. *See Penn Central Transportation Co. v. New York City*, 438 U.S. 104, 124 (1978).

Three parts of the cable financial equation are particularly important: cost, capital, and reasonable profit. These are facially simple terms, but their interrelations are especially important to the Commission's deliberations in this matter.

First, cable operators have many direct and indirect costs. The Commission must carefully consider all of the costs of providing cable service, including those arising from the direct costs of program acquisition, administration and overhead, and those associated with obtaining capital to construct, acquire or enhance a cable system. The operation of a cable system involves substantial tangible and intangible costs. Equipment and plant become obsolete quickly and thus must be depreciated over relatively short periods of time. The costs of obtaining and maintaining subscribers and the franchises are significant and thus the amortization of these items is a substantial cost of business for almost all cable operators. This has been recognized by the accounting industry in its GAAP procedures as well as by the Securities and Exchange Commission in its financial reporting rules. The Commission must

therefore also recognize these costs and provide for their full recovery in any regulatory scheme it develops.

Second, the Commission must consider the cable operator's ability to attract capital. The cable industry has used all of the traditional forms of capital available in the public and private markets, conventional and subordinated debt, common and preferred equity, and many hybrid financial forms. This access to capital has allowed the industry to grow and to build a technologically enhanced communications network past more than ninety percent of the homes in the United States and to provide the new and attractive programming described above. But this investment in the industry must be recouped and the cable industry allowed to generate sufficient future profits so it can continue to compete fairly in the multimedia environment of the nineties.

Thus, foremost in any regulatory scheme developed by the Commission must be a provision to allow the cable industry to repay its current financial obligations and provide a fair return on the market value of its investment. Moreover, future profits must be sufficient to allow for continued technological and programming improvements and new services. These obligations are a fundamental part of the direct costs of cable operators and must be provided for by the Commission.

Finally, any form of rate regulation must include a provision for reasonable profit.<sup>5/</sup> This profit must compensate the owners of a cable system for

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<sup>5/</sup> The industry has not made profits in the past. Investments have been made with a long-term view on the expectation that future profits will be made.

the opportunity cost of diverting resources to be used to provide cable service<sup>6/</sup> and for the additional risks created by future expenses imposed on the system. As a consequence, pass-throughs for increased costs and inflation are not, in and of themselves, sufficient to compensate the cable operator. There must be adjustments to account for the future capital opportunity costs imposed by those increases as well. Without a reasonable opportunity to obtain a fair return on their investment,<sup>7/</sup> cable operators will find themselves cut off from many sources of debt and equity and limited to the significantly reduced capital pool that will still be available. This will likely result in higher costs of doing business and thus higher subscriber service rates, a result opposite of that envisioned by the 1992 Act. Therefore, the Commission must include among the factors to determine the reasonableness of rates the full costs of capital and a reasonable return on equity to allow the cable industry to continue its growth.

C. A Sufficient Transition Period Must Be Provided To Adjust To The New Rate Regulations.

The cable industry must have enough time to adjust to the rate regulation scheme which the Commission will adopt, and the Commission itself recognizes that not all implementing steps that cable systems must take to meet

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6/ Profits also are used to improve service (i.e., investment in plant, programming, and personnel), to repay debt or to meet other obligations. Thus, profits are necessary in order for the cable system to continue as an enterprise.

7/ A fair return on investment should be based on the fair market value of the system prior to the imposition of rate regulation; anything less would be confiscatory in nature.

the obligations of the statute or its own rules must be completed by April 3, 1993.<sup>8/</sup> The Commission has proposed significant changes in how systems will be required to conduct their operations. Under the timetable imposed by Congress, however, the industry will not become apprised of the precise regulatory structure and regulations until the Commission issues its decision. The cable industry must be given sufficient lead time to adjust its pricing and marketing policies to the new regulatory scheme.<sup>9/</sup> The intricate regulatory scheme mandated by the statute makes it absolutely necessary that a period be established for gradual compliance.

CVI proposes that franchising authorities should be prohibited from regulating basic service until a period of ninety (90) days from the date the Report and Order is released. This period would allow cable operators to review benchmarks set by the Commission, and determine whether any adjustments in cable rates are necessary. In addition the Commission should agree not to act on any complaints alleging that program service rates are unreasonable for a ninety day period from the issuance of the Commission's decision. This would give the operator time to review its rate structure, and make any changes that might moot the complaint and enable the Commission to collect information from the industry regarding the process for disposing of such complaints.

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8/ Notice at ¶ 142.

9/ The inability of the industry to comment on the regulations that Commission will adopt poses serious procedural questions under 5 U.S.C. § 551 *et seq.* To the extent that the industry is not afforded a sufficient time to adjust to the new regulations, this procedural problem may be fatally compounded.

Commission regulations governing the unbundling of equipment should not become effective for one year. This pertains not only to equipment such as remotes and converters, but to inside wiring as well. Compliance with unbundling requirements will require a major restructuring in the manner in which cable operators price their services and conduct their business. Benchmarks for both basic and programming services must reflect current equipment charges during this interim period to provide sufficient time to make the transition.

II. **THE COMMISSION IS REQUIRED TO CONSIDER ALL OF THE GOALS OF THE 1992 ACT IN DESIGNING ITS RATE REGULATION RULES FOR BASIC SERVICE.**

The Commission alluded to many of the diverse goals of the 1992 Act in the *Notice*. As it explained, Congress set out specific factors to consider in designing the general parameters of rate regulation, and required the Commission to ensure that reasonable rates are charged for a group of services to be designated as basic service. Further, Congress hoped to reduce the administrative burden on subscribers, cable operators and regulators in the new regulatory scheme.<sup>10/</sup>

At the same time, the 1992 Act set out objectives to be weighed as the Commission considers rate regulation. The statute intends, among other

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<sup>10/</sup> *Notice* at ¶ 30; see 47 U.S.C. § 543(b). In addition to the criteria for basic service, the 1992 Act also specified criteria for rate regulation of cable programming services. These criteria are similar to those for basic service in many ways but afford the Commission substantially more discretion in designing a regulatory regime. *Notice* at ¶ 90; see 47 U.S.C. § 543(c).

things: (1) to achieve a low cost basic tier for all cable subscribers; (2) to assure that subscribers can acquire equipment at cost; (3) to make more services available to subscribers on an a la carte basis; and (4) to achieve equipment compatibility, and to reduce customer confusion. See 47 U.S.C. §§ 543(b)(1), 543(b)(3), 543(b)(8), 544A.<sup>11/</sup>

All of these goals must weigh in the regulatory calculus, and are interrelated. The Commission should reject approaches which give primacy to one or a few of the Act's provisions and disserve others. Instead, it should, tailor regulatory designs to meet all of the 1992 Act's objectives.

A. Cost-Of-Service Regulation Will Not Serve The Goals Of The Act.

In the *Notice*, the Commission tentatively concludes that it should not adopt cost-of-service as the model for the rate regulation mandated by the 1992 Act. *Notice* at ¶ 33. This conclusion is correct. Cost-of-service regulation would not serve the goals of the Act because it is costly and complicated, because it cannot guarantee that the Act's rate goals will be achieved, and because cost-of-service regulation is ill-suited to the market structure of cable service.<sup>12/</sup>

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<sup>11/</sup> See also 47 U.S.C. §§ 544(e) (technical standards); 534-535 (must carry); 325(b) (retransmission consent); 552 (customer service). Each of these provisions must be given weight in devising rate regulation.

<sup>12/</sup> In the *Notice*, the Commission also asks for comment on a variation of cost-of-service regulation, described as "Direct Costs Of Signals Plus Nominal Contribution to Joint and Common Costs." *Notice* at ¶ 53. This approach shares all of the flaws of traditional cost-of-service approaches. In addition, as described by the Commission, it exaggerates the importance of direct costs in setting

(continued...)

First, cost-of-service regulation would impose unacceptable costs and complexity on cable operators, franchising authorities, and on the Commission. Cost-of-service methodologies would require all parties to gather and interpret enormous amounts of data in order to determine the exact costs faced by each cable system and the proper rate of return for each industry segment.<sup>12/</sup> For instance, when the Commission represcribes the rate of return for telephone companies, the process takes many months, and telephone companies and other parties submit literally thousands of pages of data. Traditional cost-of-service methodologies require careful monitoring to assure that the regulated party does not exceed its rate of return if, for instance, increases in productivity decrease costs. For these reasons, the Commission found in the Price Cap Proceeding that administering cost-of-service regulation (described in that proceeding as "rate of return") "is a difficult and complex process, even when done correctly and well." *Policy and Rules Concerning Rates for Dominant Carriers*, Report and Order and Second Further Notice of Proposed Rulemaking, 4 FCC Rcd 2873, 2890 (1989).

This burden would be multiplied enormously to meet the demands of the 1992 Act. Under the 1992 Act, individual franchising authorities have the

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<sup>12/</sup> (...continued)  
reasonable rates, despite the 1992 Act's emphasis on considering many different factors.

<sup>13/</sup> None of this information is currently available and before any cost-based regulatory scheme could be put into place a uniform system of accounting would have to be designed and implemented nationwide. Even in the best of circumstances one or two years' delay would result.

responsibility for basic service rate regulation, which means that thousands of different regulators, many of whom are not well versed in such regulatory methodology, could have to consider the difficult issues raised by cost-of-service regulation. See 47 U.S.C. § 543(a). Imposing this complicated task on local franchising authorities and cable operators is directly contrary to the 1992 Act's mandate that "the Commission must seek to reduce the administrative burdens" on all parties. Notice at ¶¶ 30, 58.

Thus, the Commission should affirm its tentative conclusion that cost-of-service regulation would be unsuitable for the cable television industry.

**B. The Commission Should Adopt Benchmarking As The Standard Form Of Rate Regulation For Basic Service.**

**1. Benchmarking Is A Superior Approach To Rate Regulation.**

While cost-of-service regulation is undesirable, benchmarking is entirely consistent with the mandates and objectives of the 1992 Act.

Benchmarking not only serves the mandate for reduced administrative burdens, but also assures reasonable rates and will give cable operators incentives to operate efficiently.

First, benchmarking will minimize administrative burdens on both cable operators and franchising authorities. Benchmarking will make many basic service rate proceedings largely *pro forma* affairs, requiring only the comparison of the proposed rate to an easily-calculated maximum allowable rate. There will be no need for complicated reporting on direct and indirect costs and revenues,